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SUBJECT: Developing a Private Sector-Led Rural Finance System in Afghanistan

SUMMARY

¶1. (SBU) The financial sector in Afghanistan has made significant progress in establishing a market-based system for access to credit in rural areas. With substantial U.S. Government (USG) assistance, financial services are expanding to meet agricultural market needs and demonstrating that lending to micro, small and medium agricultural enterprises (MSMEs) can be profitable. While the challenges remain great, the USG will build upon progress achieved and rollout new innovative approaches. New interventions will focus on incentive programs for commercial banks to lend to agribusinesses, extending a network of Islamic cooperatives that have a proven track record in conservative rural areas, combining credit with business services, developing sharia-compliant agricultural products, and expanding credit to farmers for primary inputs through lines of credit to farm stores.

¶2. (SBU) Interventions will also support innovative information and communication technology (ICT) approaches, such as mobile banking, which offer new hope of extending finance to rural areas where it is currently cost prohibitive to build a brick-and-mortar branch. In addition, USG seeks to enhance collaboration with regional development platforms and Provincial Reconstruction Teams (PRTs) in order to build up a rural finance sector in newly-secured areas. In those areas where the market will not be able to attract private sector lenders, the USG will collaborate with other donors in supporting the Government of the Islamic Republic of AfghanistanQs (GIRoAQs) Rural Enterprise Development Program (ARED) which has a village cooperative savings and loan component. End Summary.

ASSISTANCE TO DATE

¶3. (SBU) When the Taliban fell from power in 2001, AfghanistanQs national finance system, not to mention its rural finance system, had totally collapsed. Increasing employment opportunities and incomes in rural areas

remains a top priority with access to credit serving as a critical component of the USG's strategy to stabilize rural areas in Afghanistan.

14. (SBU) Today, Afghanistan's national financial sector hosts 17 commercial banks operating 200 branches in more than 20 of Afghanistan's 34 provinces with \$972 million in loans outstanding to just over 42,000 active clients; and 16 microfinance institutions (MFIs) that are partners with the USG-supported Microfinance Investment Support Facility for Afghanistan (MISFA), a GIRoA/donor supported apex organization which has been a model of donor coordination. MISFA-supported MFIs report 450,000 active clients; one credit union network with 25 outlets and over 10,000 borrowers, nearly 3,800 of whom are using their loans for agriculture purposes. While the cost of capital remains high on the commercial market, targeted programs are making progress at making affordable capital available.

15. (SBU) Commercial Banks and Credit Guarantees: The USG is working directly with commercial banks to expand agricultural business credit. Technical assistance provided to four commercial banks has resulted in more than 1,700 loans through 12 branches to key agriculture value chains, including dry fruits, cashmere, pistachios, yellow pulse, fresh fruits, and medicinal plants. A \$20 million Development Authority Credit guarantee was provided in late 2008 to Bank Alfallah to increase lending to agricultural SMEs that normally wouldn't qualify for loans. This facility is available at the bank's regional

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branches in Kabul, Mazar, Herat and Jalalabad.

16. (SBU) Credit Unions: The USG works with credit unions, referred to as Islamic Investment and Finance Cooperatives (IIFCs), which have been successful at reaching smaller farmers that commercial banks typically shun. IIFCs are unique not only because they are Shara-compliant, but also because they are community-owned institutions that provide custom-tailored services in the rural markets in which they work. Granting local Shura Boards the authority to sanction loans and verify that borrowers are of good ethical and financial standing ensures community support. Nearly 86 percent of IIFCs portfolio in the south derives from agricultural markets.

17. (SBU) Microfinance Institutions: Reaching even further down market are seven USG-supported MFIs, which together have provided more than 163,000 loans. About 25 percent of the portfolios of these institutions are invested in agricultural and agriculture-related enterprises.

18. (SBU) Value Chain Financial Actors: The USG is supporting increased rural incomes and the security of those incomes through mechanisms under which farmers receive inputs on credit such as seeds and fertilizer with payments deducted when the produce is harvested and sold to the financier. Farmers are well-acquainted with this model of financing as it is used extensively under the informal system of financing.

19. (SBU) Non-Bank Financial Company: In 2006 the USG established the Afghanistan Rural Finance Company (ARFC), a non-bank finance institution which is playing a key role in providing investment capital to the agricultural sector. A for-profit Afghan entity, the ARFC has issued \$14 million in direct loans averaging \$300,000 to cooperatives, private agribusinesses and rural SMEs, particularly in the eastern and southern regions of the country.

LOOKING FORWARD

¶10. (SBU) Innovations in Rural Finance: Over the next few years, in support of the USG's priority to bring stabilization to the south and east, USG programs will continue to increase employment opportunities and incomes in rural areas by rewarding its most successful rural finance initiatives, such as the sharia-compliant cooperative model, increasing access to farm credit through farm stores, continuing to couple incentive programs for commercial banks and MFIs to do agricultural lending with technical assistance, combining finance to agribusinesses with services, such as training or quality control, and ramping up support through an already-established GIROA assistance program to rural areas.

¶11. (SBU) The USG will expand incentive programs to develop new sharia-compliant credit products and assist commercial banks and MFIs to establish SME/Agribusiness windows for extending loans to agribusiness. The USG will also expand credit for agricultural inputs by extending lines of credit to farm stores that have traditionally provided store credit to farmers. Interventions will also support innovative ICT approaches, such as mobile banking, which offer new hope of extending finance to rural areas where it is currently cost prohibitive to build a brick and mortar branch. Support for the GIROA's Afghanistan Rural Enterprise Development Program (AREDP) village savings and loan cooperative program will deliver access to credit in rural areas where providing commercially-based services is not yet feasible.

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¶12. (SBU) Civ-Mil Coordination: The United States Agency for International Development (USAID) will enhance its collaboration with regional development platforms and PRTs in order to build up the rural finance sector in newly-secured areas. Under the strategy currently under development, USAID resources will oversee capacity-building efforts to ensure the sustainability of rural financial institutions like the IIFCs, while military-sponsored funds from the Commander's Emergency Response Program (CERP) will help to subsidize the construction of new infrastructure.

EIKENBERRY